San Jose Mercury News

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Prop. 13 shortchanges communities

By James U. Hall and John E. Upton

A recent Field poll of Californians indicated substantial majorities had a positive view of Proposition 13, the law that severely limits property tax increases except when real estate changes hands. This poll was like asking people if they would like to see their taxes increase, without pointing out what the additional government revenue might be used for, or what the unintended consequences of Proposition 13 have been.

No mention was made that California now spends less than half of the amount per pupil on its public schools than New Jersey. The shortfall in funding can be traced largely to Proposition 13.

The great resulting tax disparity can be found locally. On a West Valley cul-de-sac sit 11 homes. Six families are pre-Proposition 13 taxpayers who pay a total of $14,200 worth of annual property taxes. The other five pay $125,000. The average age of six original owners is 77, whereas the average age of the other five is 50.

Most people are unaware that, in addition to protecting single-family residential property from sharp property tax increases, Proposition 13 also shelters industrial and commercial property. In general, property owned by a corporation or partnership will not be reassessed until more than 50 percent of the ownership of the corporation or partnership changes hands. Careful planning can avoid such ownership changes for many decades, even after some of the shareholders or partners die.

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Even more startling, if real property was owned by a corporation or partnership before the passage of Proposition 13, it will never be reassessed, barring a sale, unless there is a shift of control of the corporation or partnership to a single individual or a single entity. That means, for example, that property owned by PG&E prior to Proposition 13 will essentially never be reassessed, since no one person or entity is likely to ever gain control of PG&E by owning more than 50 percent of its stock.

Proposition 13 has caused a steady shift of the property tax burden from commercial and industrial property to residential property. Commercial and industrial property is even more likely than residential property to be locked into pre-Proposition 13 assessments. Seniors who want to move to a less expensive home generally face a steep increase in property taxes, which causes them to stay where they are. This locks in outdated assessments, thus denying the community the additional tax revenues that would be paid by a new homeowner.

This works to the advantage of neither the elderly nor the community. State and federal tax laws, when combined with Proposition 13, discourage millions of homeowners, especially seniors, from moving. Homeowners are entitled to a $250,000 per person exemption when they sell their home. However, on sales above that amount, they pay a 15 percent federal and a 9.3 percent state capital gains tax. Seniors pay it wherever they move, even to assisted living units, where there are often heavy up-front fees.

The death of a spouse also creates a disparity in tax treatment. While an elderly couple pays the full capital gains when they move, a surviving partner pays no capital gains tax on a sale following the death of his or her spouse.

The home is reassessed on a "stepped up" basis. Take a home purchased for $50,000 in 1965 and sold for $2.5 million in 2008. A current surviving spouse pays no tax while a couple selling would pay as much as $500,000, depending on improvements. This step-up provision is an enormous additional disincentive to move for those seniors who are aware of it. For those who aren't, their ignorance creates a huge inequity. Assisted living facilities are full of elderly who paid capital gains plus a large up-front fee to get into a retirement home, then find themselves in a financially-vulnerable position.

We suggest three solutions:

- Seniors over 65 should be allowed to move anywhere in California without paying increased property tax, as long as they are moving to a less expensive residence.
- Proposition 13 protections should be gradually removed from commercial and industrial property, increasing funding for schools and stopping the property tax burden from shifting to residences.
- Capital gains taxes should be eliminated for sale of a home by seniors over 65.

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